NO. 82-1306

IN THE

Supreme Court of the United States

October Term, 1982

COLUMBIA GAS OF WEST VIRGINIA, INC.
Petitioner,

v.

PUBLIC SERVICE COMMISSION
OF WEST VIRGINIA
Respondent.

On Petition For A Writ
Of Certiorari To The
Supreme Court Of Appeals
Of West Virginia

BRIEF OF RESPONDENT PUBLIC SERVICE COMMISSION OF WEST VIRGINIA IN OPPOSITION

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QUESTIONS PRESENTED FOR REVIEW

Whether, in determining rates of a public utility, the disallowance of unreasonable expenses associated with deliveries of synthetic natural gas pursuant to a contract with an affiliate, and the establishment of natural gas purchasing standards to be followed in the future by that utility, constitute a violation of the Commerce Clause of the United States Constitution, a violation of the Supremacy Clause of the United States Constitution, a deprivation of property without due process in violation of the Fourteenth Amendment to the United States Constitution, confiscation of assests in violation of the Fourteenth Amendment to the United States Constitution or a denial of the equal protection of the laws in violation of the Fourteenth Amendment to the United States Constitution.

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On Petition for a Writ of Certiorari
to the Supreme Court of Appeals
of West Virginia

BRIEF OF RESPONDENT PUBLIC SERVICE COMMISSION OF WEST VIRGINIA IN OPPOSITION

The respondent, the Public Service Commission of West Virginia, herewith opposes the petition for a writ of certiorari to the Supreme Court of Appeals of West Virginia filed by the petitioner, Columbia Gas of West Virginia, Inc.[1]

[1]Pursuant to Rules 22 and 34.2, respondent adopts the portions of the petition filed in response to Rule 21.1(b), (d) and (e).

ADDITIONAL STATUTORY PROVISIONS

West Virginia Code §24-1-1 provides in pertinent part:

> (a) It is the purpose and policy of the legislature in enacting this chapter to confer upon the public service commission of this State the authority and duty to enforce and regulate the practices, services and rates of public utilities in order to:
>
> * * *
>
> (4) Ensure that rates and charges for utility services are just, reasonable, applied without unjust discrimination or preference and based primarily on the costs of providing these services; . . .
>
> * * *
>
> (b) The legislature creates the public service commission to exercise the legislative powers delegated to it. The public service commission is charged with the responsibility for appraising and balancing the interests of the State's economy and the interests of the utilities subject to its jurisdiction in its deliberations and decisions.

STATEMENT OF THE CASE

The petition filed in this case arises out of two cases before the Public Service Commission of West Virginia (Commission), Case Nos. 80-336-G-30C and 81-366-G-30C. Both of these cases were filed by Columbia Gas of West Virginia, Inc. (Columbia) to pass through to its customers purchased gas costs pursuant to the Commis-

sion's purchased gas adjustment (PGA) procedure.[2] The dispute which has led to the filing of the petition herein results from the disallowance by the Commission of certain gas expenses emanating from a contract between Columbia and its affiliate, Columbia LNG Corporation (LNG Corporation). In order to understand adequately the factual situation which gave rise to the subject case, it is helpful to review the past history of the aforesaid contract as it involves the Public Service Commission.

BACKGROUND

In 1973, the Petitioner entered into a contract with LNG Corporation for the purchase of synthetic natural gas (SNG) at LNG Corporation's reforming plant in Green Springs, Ohio, with a contract term of ten years. The contract contains what is known as "take or pay" provisions, which require that Columbia must pay for total contract volumes whether or not Columbia actually uses, or takes, those volumes.[3] Columbia did not file a petition with the

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[2]Rule 30C of the Commission's *Rules and Regulations for the Government of the Construction and Filing of Tariffs of Public Utilities and Common Carriers by Motor Vehicle* is a voluntary accelerated rate procedure available to natural gas utilities subject to the jurisdiction of the Commission. Rule 30C provides a mechanism whereby gas utilities may recover increases in the cost of gas purchased from their suppliers in a more timely fashion than would be possible in a general rate proceeding. The purchased gas costs derived from Rule 30C reflect the actual cost of gas from suppliers, and adjustments for allowable line losses and taxes and over or under recoveries from a preceding twelve month period. Rule 30C applications are to be filed on or before August 1 of any given year and increased rates pursuant to Rule 30C go into effect on November 1 of that same year.

[3]Pursuant to the contract between Columbia and LNG Corporation, Columbia is obligated to take, or pay for, 4,954,100 Mcf of SNG per year.

Commission seeking approval of and consent to Columbia's entering into the contract as required by *West Virginia Code* §24-2-12.[4]

In 1976, after learning of the contract, the Commission ordered Columbia to submit the contract to the Commission for review, pursuant to the aforesaid *Code* section, in West Virginia Public Service Commission Case No. 8000, reported at 63 ARPSCWV 559.[5]

On August 10, 1976, Columbia filed a petition requesting the Commission's consent to and approval of the sales agreement between Columbia and LNG Corporation. By order entered on Dec. 10, 1976, in Case No. 8817, 64 ARPSCWV 1029, the Commission stated:

> "IT IS, THEREFORE, ORDERED that the Commission should and hereby does, grant its consent to the entering into the aforesaid sales agreement and service agreement by Columbia, without approving the terms and conditions thereof; provided, however, that such consent shall not be deemed to bind the Commission in any ratemaking proceeding involving Columbia."

Beginning with Case No. 8000 and extending through a long series of general rate proceedings and Rule 30C pro-

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[4] *West Virginia Code* §24-2-12 is set forth *in toto* in the Appendix to the Petition for a Writ of Certiorari in this case, cited as Pet. App., 146a, 147a. The pertinent provision states as follows: "Unless the consent and approval of the public service commission of West Virginia is first obtained . . . (f) No public utility subject to the provisions of this chapter . . . may, by any means, direct or indirect, enter into any contract or arrangement for management, construction, enginenering, supply, or financial services or for the furnishing of any other service, property or thing, with any affiliated corporation, person or interest."

[5] Annual Report of the Public Service Commission of West Virginia.

ceedings, including Cases Nos. 8817, *supra;* 9147, 66 ARPSCWV 488 (1978); 79-088-G-42T, _____ ARPSCWV _____ (July 17, 1980); and 79-279-G-30C, 67 ARPSCWV 1362 (1979), the Commission has refused to allow Columbia currently to recover in its rates the full costs associated with the SNG contract.

THE CASE BELOW

The instant case arises out of the two aforesaid Rule 30C proceedings before the Public Service Commission. On August 1, 1980, Columbia filed an application with the Commission to change rates for natural gas service in compliance with the Commission's Rule 30C, which case was designated as Case No. 80-336-G-30C. By order entered by the Commission on August 27, 1980, the application was set for hearing to be held on October 7, 1980, at which time the parties to the proceedings were to address all relevant issues, including: (1) the need for synthetic natural gas based upon the most recent gas supply-demand data; and (2) considering recent communications from Columbia to the Commission, the extent to which SNG and liquified natural gas (LNG) could be replaced by other supplies of gas. Columbia was also ordered to present detailed evidence related to the reasonableness of its proposed purchased gas costs in general. That hearing was held as scheduled with further hearings being held in October of 1980.

On October 31, 1980, the Commission issued an Interim Order in that case, approving an interim purchased gas cost for Columbia to be effective for all gas supplied on and after November 1, 1980, which rate was to be subject to modification as the result of any subsequent decision regarding the cost of SNG and its inclusion in Columbia's cost of purchased gas.

On August 3, 1981, Columbia filed another application

with the Commission pursuant to Rule 30C, seeking a further increase in rates to reflect increased purchased gas costs to be effective November 1, 1981, which case was designated as Case No. 81-366-G-30C.

On October 30, 1981, the Commission issued its final order in Case No. 80-336-G-30C, determining that it had the authority and jurisdiction to exclude, from Columbia's cost of purchased gas, the full cost of the SNG volumes purchased by Columbia from LNG Corporation and to reprice those volumes to the projected Columbia Gas Transmission Corporation (Transmission Corporation) average commodity rate. Additionally, the Commission ordered that the repricing of SNG to the actual pipeline rate per Mcf be reflected in the actual cost recovery mechanism of Rule 30C in Case No. 81-366-G-30C. Also on October 30, 1981, the Commission issued an order in Case No. 81-366-G-30C, which established a procedural schedule in that case calling for further hearings to be held beginning in January of 1982, and allowed Columbia to place an increased purchased gas increment into effect, pending the further hearings and final decision.

On November 9, 1981, Columbia filed a Petition for a Corrective Order or for Rehearing and Reargument in Case No. 80-336-G-30C, as well as a Petition for Hearing and Argument with respect to the portion of the order in Case No. 81-366-G-30C which adopted the policy of repricing SNG in accordance with the Commission's order in the 1980 case, which petitions were consolidated for hearing. Hearings commenced in the consolidated cases on January 20, 1982 and terminated on February 8, 1982.

The evidence adduced during the hearings held in January and February of 1982 established that: 1) the SNG volumes supplied under the contract with LNG Corporation to Columbia were not needed to serve Colum-

bia's West Virginia customers; 2) Columbia has the right under three different supply contracts with Transmission Corporation to demand more than twice the amount of natural gas needed to serve its West Virginia supply area; and 3) Transmission Corporation had sufficient excess gas supplies to meet any demand which Columbia would have in its service territory. (Pet. App., 79a-86a and 108a-111a). For contract year 1981,[4] Transmission Corporation had 128.1 Bcf of gas available to meet a hypothetical 2.5 Bcf short-fall of Columbia if the SNG volumes were unavailable. The evidence in the 1981 case indicated that for contract year 1982, Columbia had the right, under the three supply contracts with Transmission Corporation, to demand 127.3 Bcf on an annual basis, and such volumes would be sufficient to make up any potential short-fall associated with a failure to take the SNG. (Pet. App., 84a). The cost of SNG for the 1982 contract year, before consideration of West Virginia Business and Occupation Taxes, was $5.952 per Mcf, while the average commodity rate which Columbia was projected to pay Transmission Corporation for all of its other gas volumes was $3.853 per Mcf for the same rate period. (Pet. App., 129a).

On June 28, 1982, the Commission issued its consolidated Order on Reconsideration in Case No. 80-336-G-30C and Final Order in Case No. 81-366-G-30C, repricing the SNG volumes to a rate of $3.853 per Mcf, which includes $0.35 per Mcf transportation charge recovered by Transmission Corporation under its SGES schedule.

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[4]A contract year runs from November 1 of the previous year through October 31 of the contract year; thus, contract year 1981 represents the period from November 1, 1980 through October 31, 1981, and contract year 1982 represents the period from November 1, 1981 through October 31, 1982.

Based on the evidence, the Commission determined that it was unreasonable to require Columbia's West Virginia customers to pay the full cost of the SNG volumes in Columbia's rates when those volumes were not needed to serve Columbia's West Virginia customers and were of no practical benefit to Columbia's West Virginia service territory. (Pet. App., 79a-86a).

The other major section of the Commission's Order of June 28, 1982, dealt with the reasonableness of Columbia's management practices and gas procurement policies. The Commission determined that it had the authority and obligation to investigate the reasonableness of Columbia's purchasing practices with regard to the volumes of natural gas which it buys and its management practices with regard to the operation of the company. (Pet. App., 93a-106a).

During the course of hearings, the Commission received extensive testimony from residential customers, representatives of industrial firms and union representatives detailing problems which were caused by continued increases in utility bills, particularly by bills for natural gas service. The industrial sector is the only area of Columbia's market which has real growth potential, but this market is also the market which is most price sensitive due to its capacity to switch to alternate fuels. For contract year 1982, the West Virginia industrial load was expected to comprise 40% of Columbia's total annual sales, but Columbia's industrial customers have the alternate fuel capacity to replace up to 24% of Columbia's total sales with No. 2 or No. 6 Fuel Oil. (Pet. App., 100a). Columbia could lose 10% of its projected sales contract year by the switching of one industrial customer (Weirton Steel Division of National Steel Corporation) to No. 6 Fuel Oil. (Pet. App., 100a).

However, the evidence in the case demonstrated that, in spite of the importance of Columbia's industrial load to its

annual sales and the extreme price sensitivity of this market, Columbia had made no effort to keep the price of natural gas as low as possible. The Commission found that there was no single management employee in the Columbia Gas System whose responsibility it was to look out for the interests of Columbia's customers in the Columbia Gas System and that Columbia had made no effort to attempt price adjustments which would encourage growth for the industrial market. (Pet. App., 101a). The evidence further indicated that Columbia had never conducted any price elasticity studies in order to determine the optimal level of natural gas rates in order to maximize customer load and had made no effort to determine at what point natural gas increases would be created by no rate increase. (Pet. App., 101a-2a).

The record in the case demonstrated that: 1) Columbia had not aggressively sought out supplies of gas other than Transmission Corporation gas, even though those other supplies may be priced at a cheaper rate; 2) Columbia had never inquired into or contested the mix of gas supplied to it by Transmission Corporation; 3) Columbia had not actively participated in cases before the Federal Energy Regulatory Commission which could result in lower prices charged by Transmission Corporation to Columbia and Transmission Corporation's other customers; 4) Columbia had failed to attempt to renegotiate the SNG contract with LNG Corporation, even in light of the considerable volumes of cheaper gas available to Columbia; and 5) Columbia never attempted to sell the SNG to a third party, either through an off-system sale or through a private contract with a company willing to pay a higher price for an assured supply of natural gas. The evidence in the case demonstrated that Columbia's management simply relied upon Transmission Corporation to acquire gas supplies at the most reasonable price and that Columbia's management was uninformed regarding contracts between

Transmission Corporation and its suppliers. A summary of the evidence concerning Columbia's management practices and gas procurement policies is set forth in the Appendix to the Petition for a Writ of Certiorari in this case at pages 94a through 103a.

As a result of the evidence and record established in this case regarding Columbia's management practices and gas procurement policies, the Commission set forth four new standards of care to be followed by Columbia in the Future. The first standard would require Columbia to let out bids for the purchase of some quantity of natural gas supplies needed to fulfill its customer requirements. The second standard, as modified, would require Columbia to make a substantial effort to purchase more Appalachian gas, which standard was established in light of the evidence presented in the case that Columbia refused to bargain on a good faith basis with local producers and refused to pay local producers a rate for gas even remotely approaching the Transmission Corporation commodity rate. (Pet. App., 102a). The third standard would require Columbia to bear the burden of demonstrating that dependable lower-priced supplies of natural gas are not readily available from other sources and that any contracts between Columbia and a corporate affiliate are not detrimental to the customers of Columbia. The fourth standard would require Columbia to demonstrate efforts which it has taken to represent more adequately the interests of its West Virginia customers in the Columbia Gas System, as opposed to subordinating the interests of its service area to those of the Columbia Gas System as a whole.

On July 8, 1982, Columbia filed a Petition for Rehearing and Reargument in both cases.

On August 25, 1982, the Commission issued an order on the Petition determining that there was no further consideration that could be given to the 1980 case, since the

petition of November 7, 1981 exhausted the administrative remedies available to any party in that case. The Commission additionally denied the petition filed in the 1981 case.

On July 28, 1982, and September 24, 1982, Columbia filed petitions for appeal from the Commission's Orders of June 28 and August 5, 1982, with the West Virginia Supreme Court of Appeals. The two petitions were set for hearing to be heard by the West Virginia Court on November 9, 1982. Following oral argument, on November 9, 1982, the West Virginia Supreme Court of Appeals denied the petitions filed by Columbia in both cases.

It is from those orders of the West Virginia Supreme Court of Appeals that the Petitioner seeks the review of this Court by Certiorari.

REASONS FOR DENYING THE WRIT

While the impact of the Commission's decisions complained of herein are significant to Petitioner, Petitioner has failed to demonstrate a justification for further review of the Commission's decision by this Court. As demonstrated below in a brief analysis of the five claims raised in the petition, the actions of the Commission are consistent with statutory responsibilities, do not conflict with relevent decisions of this Court or other courts, and do not involve a question of Federal law which has not been settled by this Court. Under the circumstances the Court should deny the petition.

I. West Virginia Has Not Violated the Commerce Clause of the United States Constitution

The Petitioner in this case contends that the Public Service Commission of West Virginia has committed two acts repugnant to the Commerce Clause of the United States Constitution. First, the Petitioner asserts that the Com-

mission's action in repricing the SNG volumes constitutes an impermissible interference with interstate commerce. Second, Columbia asserts that the new standards set forth in the Commission's orders, by which Columbia's practices of acquiring natural gas will be examined in future regulatory proceedings, constitute economic protectionism which is incompatible with the requirements of a freeflowing interstate commerce. Columbia has misstated both of the Commission's actions in its petition.

The Commission's action to reprice the SNG volumes neither places an impermissible burden on interstate commerce nor prohibits Columbia from carrying out its obligations under the SNG contract.[7] The Commission's action to reprice the SNG volumes merely regulates prices to recover costs incurred by a local distribution company engaged in intrastate commerce and does not attempt to regulate the rate for gas delivered in interstate commerce. This Court has long upheld the authority of states to regulate direct sales by a company for consumptive uses in intrastate commerce, whether by an intrastate public utility such as Columbia, or by an interstate pipeline company. *Panhandle Eastern Pipe Line Company* v. *Public Service Commission,* 332 U.S. 507 (1947); *Public Utilities Com-*

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[7]The Federal Power Commission determined that it has no authority to regulate contracts for the sale of SNG volumes since the provisions of the Natural Gas Act apply only to the sale in interstate commerce of unmixed natural gas or any mixture of natural and artifical gas. *Re: Columbia LNG Corporation,* FPC Opinion No. 669, 1 PUR4th 574 (1973); *Re: Algonquin SNG Inc.,* FPC Opinion No. 637, 97 PUR3d 299 (1972). The *Algonquin* decision of the FPC was expressly affirmed in *Henry* v. *Federal Power Commission,* 513 F. 2d 395 (1975) and again in *Public Service Commission of New York* v. *Federal Power Commission,* 543 F. 2d 392 (1976). Thus, since the applicable Federal regulatory authority has determined that it has no jurisdiction over contracts for the sale of unmixed synthetic natural gas, there can be no Federal preemption of the SNG contract.

mission of Ohio v. *United Fuel Gas Company,* 317 U.S. 456 (1943); *Panhandle Eastern Pipe Line Company* v. *Michigan Public Service Company,* 341 U.S. 329 (1951); *Federal Power Commission* v. *Transcontinental Gas Pipe Line Corporation,* 365 U.S. 1 (1961); *Federal Power Commission* v. *Southern California Edison Company,* 376 U.S. 205 (1964).

Additionally, the Commission's action to reprice the SNG volumes does not violate the plain language of the Commerce Clause, since the decision does not impose a direct burden upon interstate commerce, but merely regulates the sale and delivery of natural gas in intrastate commerce by a public utility subject to state regulation. *Missouri* v. *Kansas Natural Gas Company,* 265 U.S. 298 (1924); *Federal Power Commission* v. *Southern California Edison Company,* 376 U.S. 205 (1964); *Great Atlantic and Pacific Tea Company, Inc.,* v. *Cottrell,* 424 U.S. 366 (1976).

Finally, this Court has previously held that it is appropriate for a regulatory body to disallow expenses which reflect managerial inefficiency, waste, imprudence, or abuse of discretion and that intercorporate agreements among affiliates do not control the price to be paid by consumers if the resulting rates require the ratepayers to bear unfair or unreasonable costs. *West Ohio Gas Company* v. *Public Utilities Commission of Ohio,* 294 U.S. 63, 72 (1935); *Smith* v. *Illinois Bell Telephone Company,* 282 U.S. 133 (1930); *Western Distributing Company* v. *Kansas,* 285 U.S. 119 (1932); *Dayton Power & Light* v. *Public Utilities Commission of Ohio,* 292 U.S. 290 (1934); *Columbus Gas & Fuel Company* v. *Public Utilities Commission of Ohio,* 292 U.S. 398 (1934).

The Petitioner asserts that the new gas procurement standards announced by the Commission seek specifically to put West Virginia gas in a favorite position *vis-a-vis* gas produced in other states and transported in interstate com-

merce and, thus, are "obvious manifestations of parochialism." The new standards imposed upon Columbia by the Commission regarding its gas procurement policies do not impose an impermissable burden on interstate commerce. They are reasonable standards by which to judge the efforts of an intrastate distribution company to provide its customers with the most reasonably priced and readily available supplies of gas. The standards require Columbia to purchase the least cost gas readily available and to exercise greater judgement and independence in its gas procurement policies. The standard requiring Columbia to make more of an effort to purchase West Virginia gas is simply a recognition that the evidence in the instant cases demonstrated that, currently, the gas available in West Virginia and the Appalachian area is less expensive than the gas currently being purchased by Transmission Corporation and is considerably less expensive than the cost of the SNG purchased by Columbia from LNG Corporation. The evidence indicates that Columbia has refused to deal with Appalachian producers on an equitable basis (Pet. App., 102a). The new standards merely require Columbia to treat all potential gas supplies on an equal footing, whether they are locally produced or delivered by an interstate pipeline.

Moreover, the new standards enunciated for future application to Columbia's gas procurement policies are not yet ripe for judicial review. They were not applied to Columbia in the instant cases. The reasonableness of those standards will be further addressed by the Commission and the Commission's Staff when they utilize those standards for the first time. If the Commission applies those standards to Columbia's purchasing practices, and, as a result, refuses to allow Columbia to fully recover in rates future purchased gas costs, Columbia will have an opportunity to fully litigate the appropriateness of those standards. Any underrecovery of gas costs subsequently deter-

mined to be legitimate by a reviewing court would be included in the over/underrecovery mechanism of Rule 30C. Thus, the action of establishing standards for future application fails to meet the two-pronged test for ripeness set forth by this Court in *Abbott Laboratories* v. *Gardner*, 387 U.S. 136, 149 (1967). Those criteria are: 1) fitness of the issue for judical decision and 2) the hardship to the parties of withholding Court consideration.

II. The Commission Has Not Violated the Supremacy Clause

Columbia argues that the Commission has intruded upon a federally preempted area by denying a transportation cost incurred by Columbia under a FERC-approved tariff in the process of repricing SNG to the Transmission Corporation average commodity rate. Columbia has misunderstood the action of the Commission with regard to the transportation costs. The average commodity rate charged by Transmission Corporation to Columbia Gas of West Virginia consists of two increments — the actual cost of the natural gas and a transportation charge. In the $3.853 per Mcf average commodity rate, 35 cents per Mcf represents the transportation charge and $3.503 represents the actual cost of the natural gas per Mcf. The Commission repriced the SNG volumes to the $3.853 total rate which includes the transportation charge pursuant to the FERC-approved tariff. The Commission has not attempted to look behind the transportation costs or determine whether or not the transportation charge is just and reasonable. The Commission has merely prohibited Columbia from recovering the same transportation charge twice. Columbia is entitled to recover in its rates a transportation charge assessed upon it for each Mcf of gas delivered to it by Transmission Corporation; however, Columbia is not entitled to recover that transportation

charge per Mcf more than one time for each Mcf delivered. Thus, the Commission has not intruded into a federally preempted area or attempted to look behind the federally approved transportation charge contained within the FERC-approved tariff of Transmission Corporation.

Columbia asserts that by establishing new standards by which this Commission would review the reasonableness of Columbia's purchases from Transmission Corporation, the Commission has transgressed into an area preempted by the Federal Government and is attempting to pass upon the rate charged for gas delivered to Columbia by Transmission Corportion, when those volumes are being priced at a rate approved by the Federal Energy Regulatory Commission. The Commission is doing no such thing. The Commission does not wish to regulate the rate Transmission Corporation charges to Columbia. That is not the intent of the new standards. However, if Columbia can purchase gas from sources other than Transmission Corporation which is less expensive than the gas which it purchases from Transmission Corporation, but fails to do so, then Columbia may not be exercising sufficient care in its gas purchasing practices. In this regard, the Commission is obligated to ensure that the rates and charges of Columbia of West Virginia are just and reasonable. *West Virginia Code,* §24-1-1(a) (4). The Commission discussed this issue at length in its order. (Pet. App., 87a-106a).

Finally, these new standards are not yet ripe for judicial review in that the Commission did not apply them to Columbia's purchases from Transmission Corporation in the cases at bar and has not yet applied them in Columbia's most recent 30-C filing before the Commission, Case No. 82-379-G-30C, which is currently pending.

III. West Virginia Has Not Deprived Columbia of Property Without Due Process of Law

The Petitioner asserts that, by repricing the SNG volumes, the Commission has in some way deprived Columbia of property without due process of law because the Commission has not previously articulated standards by which the SNG contract would be judged. Columbia asserts that it knew only that, in 1976, the Commission had examined the SNG contract and found it to be unobjectionable and that it had no idea that the Commission could attempt years later to repudiate its approval of that contract. (Petition, at 20). Columbia states that even if it had known that the Commission would, or could, retract its imprimatur at this late date, it had no way of predicting the standards by which the review of the contract would be made. (Petition, at 20).

Columbia entered into the SNG contract in 1973, three years before it was ever presented to the Commission. Thus, it would have been impossible for the Commission to articulate standards by which the contract would be judged in the future, when that contract was entered into without the Commission's knowledge and in violation of a section of the *West Virginia Code* which requires the utility to obtain Commission approval prior to entering into certain agreements with affiliates. (*West Virginia Code* §24-2-12, Pet. App., 146a) In any event, Columbia had ample knowledge of the Commission's intent to scrutinize the reasonableness of SNG expenses. On June 16, 1976, in Case No. 8000, 63 ARPSCWV 559, the Commission addressed the SNG contract for the first time. In that decision, at pages 574-575, the Commission pointed out that it need not address the legal and constitutional questions raised by the SNG contract, stating that:

> Columbia (W.Va.) admits in its brief that the charges resulting from the sale of synthetic gas

> may be subjected to a subsequent review by the Commission. That "subsequent review" is now. In other words, even if Columbia (W.Va.) must pay Columbia LNG Corporation according to contract, this Commission can disallow, for *ratemaking purposes,* a portion of the actual costs as unreasonable, excessive, improvidently incurred, or sought to be too quickly recoverable in rates to West Virginia customers . . . .
>
> In summary, therefore, even if we assume that we do not have the jurisdiction to decide the price which Columbia (synthetic) can charge Columbia (W.Va.), the Commission concludes as a matter of law that it has the jurisdiction for ratemaking purposes to adjust the actual cost to Columbia (W. Va.) of its synthetic gas purchases during the test period . . . .

In that case, the Commission denied full current recovery of the cost of SNG.

In Case No. 8817, 64 ARPSCWV 1029 (1976), the Commission did grant its consent to the entering into the SNG sales agreement and service agreement, although "without approving the terms and conditions thereof; provided, however, that such consent shall not be deemed to bind the Commission in any ratemaking proceedings involving Columbia." In Case No. 9147, 66 ARPSCWV 488 (1978), the Commission again discussed the SNG volumes stating that:

> It was decided as a matter of law in Case No. 8000 that for ratemaking purposes, the Commission has the jurisdiction to adjust the actual costs incurred by Columbia associated with SNG. In Case No. 8000, it was ordered that certain adjustments be made in the estimated cost of service prepared by Columbia LNG each year . . . .

> The Commission upholds the precedent established in Case No. 8000 of reviewing SNG costs to determine their reasonableness.

In Case No. 79-088-G-42T, Interim Order, August 27, 1979, _____ ARPSCWV _____, the Commission ordered the parties to Columbia's rate case to address the question of whether *any* level of cost recovery for SNG was just and reasonable for Columbia under the circumstances of the case. In the Final Order in Case No. 79-088-G-42T, July 17, 1980, the Commission discussed the adjustments to the SNG costs which had been made in Case Nos. 8000, 8807, and 9147 and which had been made in the interim phase of that case. In Case No. 79-279-G-30C, Columbia was ordered during the hearing to address the reasonableness of its SNG costs (Final Order, October 26, 1979). Finally, Columbia was put on notice in the order of August 27, 1980, in Case No. 80-336-G-30C, that the issue of the need for SNG and the reasonableness of the cost of the SNG would be an issue in that case. Thus, it is disingenuous for Columbia to assert that it had no knowledge that it could not rely upon the Commission's "approval" of its entry into the SNG contract by order entered in 1976.

Columbia's argument that it has been deprived of due process depends in large measure upon the proposition that once a regulatory body approves the inclusion of an expense in a company's cost of service, the agency must approve the pass-through of that expense in all future proceedings involving the same company, regardless of future developments which may alter the appropriateness of the expense. Such a proposition is not in accordance with well-settled law. This Court has long held that a regulatory body must be free to adapt its policies and decisions when faced with new developments or changing circumstances and that a decision of a regulatory body limiting contractual arrangements may not be set aside because the agency

reached a different result on an earlier occasion. *American Trucking Association v. Atchison, Topeka, and Santa Fe Railway Company*, 387 U.S. 397, 416 (1966); *Permian Basin Area Rate Cases*, 390 U.S. 747, 784 (1968); See 2 K. Davis, *Administrative Law* §18.09, at 610 (1958).

Columbia additionally asserts that it had no way of knowing what standards the Commission may have used to determine that a portion of the SNG costs were not reasonable and should not be recovered from West Virginia ratepayers. Yet the SNG costs have always been subject to the same examination and test to which any rate case expense is subject; i.e., is it reasonable and is it necessary? The Commission examined the evidence presented in the case and utilized its standard ratemaking analysis in evaluating reasonableness of this particular cost. The Commission looked at the cost of the SNG and the volumes of the SNG and examined the actual demand for natural gas of Columbia's customers. The Commission evaluated the amount of natural gas purchased from Transmission Corporation by Columbia, the amount of gas which Columbia has the right to demand on an annual basis from Transmission Corporation and the amount of gas Transmission Corporation was prepared to supply to Columbia in each of the pertinent 30C periods. On the basis of that analysis, the Commission came to the conclusion that the SNG volumes were not needed to serve Columbia's customers in West Virginia because Transmission Corporation had planned to provide Columbia with enough gas to serve virtually the entire load estimated by Columbia and because Columbia had the right to demand almost twice as much gas in the pertinent years as it actually needed to serve its customers. The Commission used no unusual or previously unknown analysis in reaching its decision in the case with regard to the need for SNG. After examining the evidence, the Commission determined that it was unreasonable to require West Virginia customers to

pay a higher cost for natural gas than was actually needed to supply them with adequate gas service. In short, the SNG expense was neither reasonable nor necessary.

Columbia has not been deprived of its property without due process of law by the Public Service Commission. Columbia has known since 1976 that the Commission was not bound to the terms of the SNG contract for ratemaking purposes and Columbia has known that the Commission has adjusted the actual cost recovery of the SNG volumes in each of Columbia's rate cases since that time.

IV. The Action of the Commission Has Not Resulted in Confiscation

To the extent that the Commission's Orders result in a rate of return on Columbia's investment which is inadequate, said inadequacy does not amount to unconstitutional confiscation.

Columbia did not, and could not, refer to any case which stands for the proposition which it advances herein, *viz.*, that notwithstanding a finding that expenses are unreasonable, the Commission must require the ratepayers to reimburse the utility if the failure to do so would result in the company's inability to earn its authorized rate of return. Indeed, this Court has previously disavowed such a result.[8]

In carrying out its statutory responsibilities, the Commission determined that the rates requested by Petitioner associated with SNG costs were unjust and unreasonable. (Pet. App., 124a, 125a). If, in order to permit the com-

[8]In *Acker* v. *United States* 298 U.S. 426 (1939), the issue before the Secretary of Argiculture was, as it is here, the reasonableness of an expense item, not confiscation. As in *Acker*, the Petitioner herein would require the ratepayers to be bound by managerial judgment even where an expense is found to be extravagant or unnecessary.

pany to earn its rate of return, the Commission were to permit the company to collect rates based upon these unjust expenses, the balancing process which the Commission is required to perform would be weighed entirely in the utility's favor and against the interests of the consuming public. That is not the result contemplated by the West Virginia Legislature and that is not the result which this Court has permitted in the past. *Permian Basin Area Rate Cases*, 390 U.S. 747, 776 (1968).

The issue of confiscation must be considered in the context of a Commission's statutory responsibility to ensure just and reasonable rates. Consequently, if an expense item is found to be unreasonable, to charge consumers for such expenses would require them to pay unjust and unreasonable rates. Under the Company's theory of confiscation, if a utility were to fail to achieve its authorized rate of return due to the Commission's disallowance of an expense item, the Commission would be required to make rates sufficient to compensate the company for its expenditures. In *Acker* v. *United States*, 298 U.S. at 431, this Court held that in the consideration of a charge for public service "regulation cannot be frustrated by a requirement that the rate be made to compensate extravagant or unnecessary costs." Also, the *Hope*,[9] *Permian Basin*[10] and *Bluefield*[11] decisions assumed efficient and economic management decisions. The record before the Commission demonstrated that Columbia's management was not efficient or economical with regard to the SNG expense. There was no effort made on Columbia's part to mitigate the impact of this high priced supply. The record shows no

[9]*Federal Power Commission* v. *Hope Natural Gas Company*, 320 U.S. 591 (1944).

[10]*Permian Basin Area Rate Cases*, 390 U.S. 747 (1968)

[11]*Bluefield Water Works and Improvement Company* v. *Public Service Commission*, 262 U.S. 679, 692, 693 (1923)

evidence of an attempt to find other buyers for the SNG and no evidence of an attempt to renegotiate the contract.

Confiscation must logically be determined on the basis of a return calculated using just and reasonable expenses with careful and prudent management. On such a basis, there has been no suggestion made that the Company's financial integrity has been impaired. If the question of confiscation should be determined on the basis of expenses actually incurred, there would be little reason for a regulatory commission to exist. Utilities could, under the guise of management discretion and the protection of a misguided theory of confiscation, incur extravagant expenses at no risk to the shareholders. Clearly, that is not the result contemplated by this Court in any of its decisions and is contrary to the history of regulation.

It is well-settled law that regulation does not insure that the business shall produce net revenues. *Federal Power Commission* v. *Natural Gas Pipeline Co.*, 315 U.S. 575, 590 (1942).

Indeed, this fact was recognized in one of this Court's leading cases on ratemaking. *Federal Power Commission* v. *Hope Natural Gas Company*, 320 U.S. 591, 603 (1944). This Court has repeatedly held that the company is required to provide service in a reasonably efficient and economical manner. The public cannot be required to pay rates to cover operating expenses in excess of those which would be incurred by a reasonably prudent management. Recorded operating expenses for a public utility enterprise need not be accepted by regulatory authorities for the purpose of fixing rates in the absence of a showing that such expenses are reasonable in amount. *San Diego Land & Town Company* v. *Jasper*, 189 U.S. 439 (1903). This Court held long ago that:

> [w]hile the protection of vested rights of property is a supreme duty of the courts, it has not come to this, that the legislative power rests subser-

> vient to the discretion of any railroad corporation which may, by exorbitant and unreasonable salaries, or in some other improper way, transfer its earnings into what it is pleased to call 'operating expenses'.
> *Chicago & Grand Trunk Railway Company* v. *Wellman*, 143 U.S. 339, 346 (1892)

The Public Service Commission Law of West Virginia requires the Commission to ensure that rates and charges for utility services are "just" and "reasonable". *West Virginia Code* §24-1-1(a) (4). Also,

> [t]he public service commission is charged with the responsibility for appraising and balancing the interests of current and future utility service customers, the general interests of the State's economy and the interests of the utilities subject to its jurisdiction in its deliberations and decisions. *West Virginia Code* §24-1-1(b)

In determining whether rates requested are just and reasonable, it is perfectly appropriate for the commission to disallow expenses resulting from managerial inefficiency, waste, imprudence, or abuse of discretion. *West Ohio Gas Company* v. *Public Utilities Commission of Ohio*, 294 U.S. 63, 72 (1935). It has previously been held that an intercorporate agreement among affiliates does not control the price to be paid by consumers if the rate thereby established results in unfair or unreasonable costs to the utility and its ratepayers. *Smith* v. *Illinois Bell Telephone Company*, 282 U.S. 133 (1930); *Western Distributing Company* v. *Kansas*, 285 U.S. 119 (1932); *Dayton Power & Light* v. *Public Utilities Commission of Ohio*, 292 U.S. 290 (1934); *Columbus Gas & Fuel Company* v. *Public Utilities Commission of Ohio*, 292 U.S. 398 (1934).

V. The Commission's Order Does Not Deny Columbia the Equal Protectionof the Laws

Columbia asserts that the Commission has approved full cost recovery for SNG purchases of four other gas utilities while it has singled Columbia out for cost disallowance. Consequently, Columbia's argument is that it has been denied the equal protection of the laws guaranteed by the Fourteenth Amendment to the United States Constitution. (See, Pet., 24-27).

The Commission has rejected this argument in its Order. The Commission's rationale for so doing is based upon findings that Columbia is not situated similarly to the other utilities and that administrative realities and constraints justify the procedure employed by the Commission. (Pet. App., 74a-76a).

The basis for the Commission's determination that Columbia is not situated similarly to the other SNG purchasers is founded upon factual determinations that Columbia is several times larger than the other utilities put together, that Columbia, unlike the other utilities, services several of the largest industries and employers in the State which have significant impact upon the State's welfare and economy, and that Columbia is the only Company which is affiliated with the supplier of the SNG. (Pet. App., 75a).

With respect to administrative realities and constraints, the Commission noted that the logical extension of Columbia's argument would require the Commission to join every utility in the State to a specific rate case before disposition of an issue which may be applicable to those other utilities. Otherwise, at any given point in time, the utilities would not be treated equally. Obviously, this is administratively impossible and is not required by the rate setting procedures. The case of *Cotting* v. *Kansas City Stockyards Company*, 183 U.S. 79, 119 (1901), cited by

Columbia on page 26 of its Petition, was an equal protection case dealing with an act of a state legislature. The holding of the Court in that case is simply not applicable to rate-setting procedures employed by a state regulatory commission. Upon enactment, legislation, by its nature, immediately defines and limits the class to which it applies. On the other hand, a rate case before the Commission involves a specific utility and the particular issue of whether that utility's costs are reasonable. To the extent principles are established in determining the reasonableness of costs which could be applicable to other utilities, the Commission will endeavor to analyze those principles within the context of a particular case. Accordingly, based upon its disposition of the issue in the Columbia case, the Commission stated its intention to investigate the reasonableness of SNG purchases by any other utility subject to its jurisdiction. (Pet. App., 76a).[12]

With respect to the affiliation issue, Columbia has ignored the clear provisions of §24-2-12 of the *West Virginia Code, supra,* which provide that contracts between a utility and its affiliate are subject to Commission scrutiny. There is no express statutory provision with respect to Commission scrutiny of contracts between a utility and a non-affiliate. Additionally, Columbia has cited no authority for its proposition that affilialtion cannot be a basis for dissimilar treatment because the authority is to the contrary. Courts have long recognized the basis for a legitimate distinction by a regulatory agency of an arrangement between utilities and affiliates *vis-a-vis* non-

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[12]Pursuant to its stated intention, cases (Rule 30C applications) involving the recovery of purchased gas costs which include SNG purchases by all other utilities in the State (five cases) have been set for hearing by the Commission. These cases are presently scheduled to go to hearing in April, 1983, wherein parties will be given an opportunity to present testimony and argument regarding the SNG issue.

affiliates involving similar expenses and have found such distinctions not be a denial of equal protection of the laws. (See, *General Telephone Company of Upstate New York* v. *Lundy*, 17 N.Y. 2d 373, 271 N.Y.S. 2d 216, 218 N.E.2d 274, 281-282 (1966), citing to *American Telephone & Telegraph Company* v. *United States*, 299 U.S. 232, 239 (1936); *Columbus Gas & Fuel Company* v. *Public Utilities Commission of Ohio*, 292 U.S. 398, 400 (1934); *Dayton Power & Light Company* v. *Public Service Commission of Ohio*, 292 U.S. 290, 295 (1934); *Western Distributing Company* v. *Public Service Commission*, 285 U.S. 119, 124 (1932); *Smith* v. *Illinois Bell Telephone Company*, 282 U.S. 133, 152-53 (1930)).

In conclusion, Columbia has not been denied equal protection of the law because it is not situated similarly to other SNG purchasers. Additionally, the Commission is presently undertaking to investigate the reasonableness of SNG purchases by all utilities subject to its jurisdiction in individual cases involving an application by each utility to recover its purchased gas costs.

CONCLUSION

There being no conflict between the actions of the Commission and the relevant decisions of this Court involving a decision of a federal question, or the decisions of other courts, the petition should be denied.

Respectfully submitted,

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